



**REVIEW OF THE MISSOURI UNEMPLOYMENT
COMPENSATION TRUST FUND**

**From The Office Of State Auditor
Claire McCaskill**

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PERFORMANCE AUDIT



Office of
Missouri State Auditor
Claire McCaskill

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Unemployment benefits for discharged workers are handled differently here than other states; action still needed to make Unemployment Insurance Trust Fund solvent

This report follows a 2002 audit on the impending insolvency of the Unemployment Insurance Trust Fund, which pays unemployment benefits to thousands of individuals each year. The report specifically addresses how the state's Department of Labor and Industrial Relations (DOLIR) handles unemployment benefits to those discharged for misconduct, which was questioned during the last report's release. In addition, this report dissects the pros and cons of the recently vetoed legislation which attempted to make the fund solvent.

Other states impose harsher penalties for misconduct discharges

Auditors found the department's oversight of discharged worker's claims generally complied with state law, but how the state penalizes misconduct discharge greatly differs from other states. Missouri is one of 12 states allowing individuals discharged for misconduct to receive full unemployment benefits after waiting a 4- to 16-week disqualification period based on the severity of the behavior. The department paid \$22.5 million in unemployment benefits during 2001 on approximately 10,000 misconduct discharge cases. In addition, 7 of these 12 states also penalize the individual along with the disqualification period, most often by reducing unemployment benefits by the number of disqualification weeks. The remaining 39 states deny unemployment benefits to anyone discharged for misconduct and the claimants must go back to work and re-qualify for benefits on a future claim. (See page 5)

Department officials could use stiffer penalties under current law

Auditors found department officials have not fully used the penalties available under current law. State law allows department officials to assess 4 to 16 weeks of disqualification on a misconduct discharge, but auditors found the department seldom imposed a waiting period of more than 4 to 8 weeks, with an average of 5.5 weeks. The recently vetoed legislation proposed eliminating these disqualification weeks on misconduct discharges, and proposed such claimants would be ineligible for benefits until they returned to work, earned at least \$2,000 and became unemployed again. Department estimates showed this change could save the state \$30 million in benefits annually. (See page 6 and 9)

Missouri handles drug-related discharge cases differently than other states

Auditors found 14 of 18 states contacted (including those surrounding Missouri) do not allow a person who failed a pre-employment drug screening to receive benefits, and denies their claim; while 17 of the 18 states also consider failure of a random drug test to be

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misconduct and deny or reduce benefits. But Missouri allows unemployment benefits for claimants on drug-related discharge cases unless signs of on-the-job impairment are found or the job is deemed safety sensitive. Courts have agreed with the department's interpretation of the law and the department will not alter its handling of such situation unless state law is changed. (See page 6)

1 percent of total benefits paid went to drug-related discharges

Auditors estimated about 1 percent of the \$476 million paid in unemployment benefits in 2001 went to claims with drug-related discharges. To reach this estimate, auditors reviewed a statistical sample of 50 drug-related discharges during 2001 and then projected to the total population. Estimates showed the department paid \$4.9 million in unemployment benefits on 1,960 drug-related discharges. About 68 percent of these claims involved misconduct and the claimant served disqualification weeks before receiving benefits, which totaled an estimated \$2.4 million. Estimates showed the department personnel found no misconduct on 32 percent of the cases, and the claimant did not have to wait before obtaining unemployment benefits. Reasons for no misconduct included employers either refused or failed to provide sufficient information to support misconduct, individuals started work but then failed pre-employment drug tests, or employers could not prove the drug use was connected to work. (see page 7)

Vetoed legislation to make fund solvent was costly to employers

Although the 2003 vetoed legislation addressed fund solvency by increasing revenue and reducing benefits, the proposed changes would have cost Missouri employers unnecessary interest, increased federal taxes levied on Missouri employers by \$275 million and did not make the fund solvent long-term. The vetoed legislation also proposed allowing the department to issue up to \$100 million in bonds to finance current and future insolvencies. The bond had to be repaid through a special assessment on all Missouri employers over a period not to exceed 10 years. Auditor analysis showed using bonds to finance the current solvency would cost employers approximately \$34 million more than financing the full insolvency through the U.S. Department of Labor. (See page 9)

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ABBREVIATIONS

DOLIR Department of Labor and Industrial Relations
USDOL U.S. Department of Labor



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Honorable Bob Holden, Governor
and
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Thousands of unemployed individuals rely on unemployment benefits from Missouri's Unemployment Compensation Trust Fund (the fund). In January 2002 we recommended actions to the General Assembly to avoid the fund's impending insolvency and ensure its long-term solvency. At that time questions were raised in regard to the Department of Labor and Industrial Relations' (DOLIR) handling of discharges involving misconduct. In May 2003, the General Assembly passed legislation increasing revenue and decreasing benefits, however, the governor subsequently vetoed the legislation. Because of the importance of the long-term financial integrity of the fund, this report focuses on the department's handling of claims involving general and drug-related misconduct discharges, and the vetoed legislation and the extent the proposed changes would ensure the long-term solvency of the fund.

We found DOLIR's management and oversight of unemployment claims related to misconduct discharges generally complied with state statutes and department guidance. However, Missouri's approach to penalizing misconduct discharge case claimants differs from other states because Missouri statutes (1) allow individuals discharged for misconduct to collect benefits after a waiting period, (2) do not reduce benefits eventually paid individuals discharged for misconduct, and (3) require evidence of job impairment for misconduct on drug-related discharges.

We also found proposed legislative changes increased revenue and reduced benefits, however, the vetoed legislation authorized the issuance of \$100 million in long-term bonds. With these bonds, all Missouri employers would incur an additional estimated \$34 million compared to the costs of borrowing only federal funds. The use of bonds also delays restoring the solvency of the fund, and does not avoid the additional \$275 million in federal taxes levied on all Missouri employers, and does not ensure its long-term solvency. Fund insolvency is forcing the department to borrow federal funds and all Missouri employers may have to incur as much as \$95 million in interest on those funds. In addition, timely identification and collection of overpayments would also contribute to fund solvency.

We have included recommendations to the General Assembly to (1) consider adding a monetary penalty equal to the number of disqualification weeks as a penalty for misconduct discharges and reviewing state statutes regarding penalties associated with drug-related misconduct discharges to determine whether implementation of the statutes reflects the intended purpose of the legislation and (2) return the fund to solvency and ensure the long-term solvency of the fund.

We conducted our work in accordance with applicable standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such tests of the procedures and records as were considered appropriate under the circumstances. The department provided comments in a meeting on July 14, 2003, and in a letter dated August 13, 2003. We have incorporated these comments as appropriate. We conducted our work between January 2003 and May 2003.

A handwritten signature in black ink, reading "Claire McCaskill". The signature is fluid and cursive, with the first name "Claire" and last name "McCaskill" clearly distinguishable.

Claire C. McCaskill
State Auditor

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INTRODUCTION

The department administers the fund which provides temporary financial assistance—unemployment benefit payments—to eligible unemployed workers and helps stabilize the economy. To meet this need, states initially administered forward-funded systems in which unemployment funds grew in good economic times and fell in stressed economic times. However, many states, including Missouri, have adopted a “pay-as-you-go” system, which matches unemployment taxes (revenue) with benefits paid during the year and reduces the tax burden on employers.

The benefits paid to unemployed workers are funded through payroll taxes paid by Missouri employers. Employer contributions are paid based on the employer's contribution rate multiplied by employee earnings, with taxable earnings not to exceed the taxable wage base (\$7,500 for 2003). States are required by the federal government to maintain a minimum taxable wage base of \$7,000. An employer's contribution rate fluctuates annually based on the employer's payroll and its use of the unemployment system. The department monitors the fund balance, as well as all employer contribution rates and employee benefit claims. Department personnel also perform fund balance projections with the primary variable being the rate of unemployment.

Missouri's trust fund became insolvent during the 1983 and 1992 recessions. Due to the 1992 insolvency, legislators changed state labor laws to increase the fund balance to acceptable levels. As a result, the fund balance increased from \$57 million at the end of 1993 to \$491 million at the end of 1998. However, the fund balance did not continue increasing in favorable economic times because changes in the law reduced the fund's growth when it reached \$500 million. Once the fund becomes insolvent, the U.S. Department of Labor (USDOL) gives the state two years to address the insolvency. If the state does not take action, USDOL increases the federal tax rate paid by all employers in the state and the increase is used to replenish the fund balance and ensure fund solvency.

Current Missouri law requires all unemployment claimants to serve a "waiting-week"—the week following an initial claim. Benefits are paid for the "waiting-week", but individuals do not receive those benefits until after receiving benefits for nine consecutive weeks. Current law also allows individuals discharged for misconduct to receive benefits. For a discharged claimant, a department representative must gather evidence from the employer and claimant to determine whether the employer discharged the individual for good cause (misconduct). A misconduct determination results in the department representative assessing between 4 to 16 disqualification weeks based on the severity of the behavior. The claimant does not receive benefits during these weeks, but must continue to claim and be otherwise eligible for benefits to satisfy the disqualification. Once all disqualification weeks have been satisfied, claimants will begin drawing benefits, assuming they have not found new employment.

Methodology

To assess the validity of department determinations on discharge related claims, we reviewed 138 unemployment claims processed by department personnel during 2001. Of the 138 claims we reviewed, 124 represented discharge claims and 14 represented voluntary separations randomly selected and reviewed by the department's quality control unit. The department is required by federal regulation to review a statistical sample of 480 claims each year as a quality control process and the 138 claims were included in the department's statistical sample. We reviewed the methodology used by department personnel to select the 480 cases and determined our review of the 138 cases would result in an audit test sample representative of discharge and voluntary quit claims universe.

To evaluate the reasonableness of department determinations specifically on drug-related cases, we reviewed an additional statistical sample of 50 drug-related claims. These claims were randomly selected from a study population of 1,960 drug-related claims identified by department personnel for 2001.¹

To compare Missouri's handling of discharge cases to other states, we performed a phone survey of 18 other states. We selected Missouri's 8 surrounding states as well as 10 other states that, according to USDOL, use disqualification weeks to penalize misconduct discharge claims in a similar manner to Missouri. Our survey also contained specific questions regarding each state's policies on drug-related discharges.

To determine factors impacting the fund's solvency, we reviewed state law and updated information contained in our 2002 report. We interviewed knowledgeable department personnel and officials and reviewed and analyzed the department's fund balance projections done at our request. We also contacted representatives of the USDOL for information on federal unemployment taxes charged to Missouri employers and how insolvency would affect those rates. In addition, we reviewed department data relevant to costs incurred by the department for benefit overpayments and overpayment collections.

We also assessed the validity of the data included in the department's information systems by (1) ensuring hardcopy documents supported the data in the mainframe system for all 188 cases reviewed, and (2) cross checking the quality control database with the mainframe data and hardcopy data for the 138 non-drug cases reviewed. No exceptions were noted.

¹See Appendix I for information on sample results.

RESULTS AND RECOMMENDATIONS

1. State's Handling of Misconduct Discharges Differs From Other States

The department's management and oversight of claims involving discharged workers generally complies with state laws and department guidance. However, how the state penalizes misconduct discharge cases differs from other states because Missouri (1) allows an individual discharged for misconduct to collect benefits after a disqualification waiting period, (2) does not reduce benefits eventually paid individuals discharged for misconduct, and (3) requires evidence of on the job impairment for drug-related misconduct discharges.

Department complies with state law in discharge determinations

Our review of 138 claim cases, involving 152 determinations,² disclosed department personnel followed state law and department guidance on 150, or 99 percent, of the 152 determinations. Two, or 1 percent, of the determinations did not follow state law.

We also reviewed an additional statistical sample of 50 determinations involving drug-related discharges and found department personnel followed department guidance on 46, or 92 percent. We estimate, based on a 90 percent confidence level, the number of drug-related determinations in which department personnel followed this guidance ranged from 1,621 to 1,905 out of a total population of 1,960 cases.³ Department guidance had not been followed on four, or 8 percent, of sampled cases. These cases involved random drug tests where the employer had not proven impairment on the job and, contrary to department guidance, department personnel determined misconduct occurred.

Other states impose harsher penalties for misconduct discharges

Missouri is one of 12⁴ states allowing individuals discharged for misconduct to receive full unemployment benefits after satisfying a disqualification waiting period. However, 7 of the 12 states also impose a monetary penalty along with the disqualification period. For example, five states reduce the amount of unemployment benefits by the number of disqualification weeks. If an individual were entitled to 16 weeks of benefits and is disqualified for 6 weeks, they would be limited to 10 weeks of benefit payments. The remaining 39 states deny unemployment benefits to anyone who has been discharged for misconduct. Instead, the claimants must go back to work and re-qualify for benefits on a future claim.⁵

²Some cases have multiple determinations because Missouri statutes require the department to review all base period job separations.

³See Appendix I for additional information on sampling.

⁴Includes the District of Columbia.

⁵See Appendix II for a listing of these states.

The department incurred \$22.5 million in unemployment benefits during 2001 on approximately 10,000 misconduct discharge cases where claimants satisfied their disqualification waiting period before collecting unemployment benefits.

Department not fully utilizing misconduct penalties available under law

Our analysis of misconduct determinations disclosed the department has not fully utilized penalties available under current law. State law allows department personnel to assess 4 to 16 weeks of disqualification on a misconduct discharge determination, based on the severity of the behavior. However, of the 48 misconduct determinations⁶ reviewed, 46, or 96 percent, of misconduct claimants were disqualified from 4 to 8 weeks, with an average disqualification of 5.5 weeks during 2001.⁷ For example, department personnel issued 5-week disqualification waiting periods for a school bus driver discharged for testing positive for cocaine, and an employee discharged for sexual harassment. In these cases, both individuals received unemployment benefits after the disqualification waiting period. On the other hand, only 2 of the 48 determinations received disqualifications of over 8 weeks—one disqualified for 12 weeks and the other for 16 weeks.

A department official told us laws do not provide guidance to assist department personnel in assessing the severity of disqualification penalties for misconduct. The official also told us the low number of average disqualification weeks is a product of informal department guidance that has not been updated since the early 1990s.

Treatment of drug-related discharge cases differs from other states

Representatives from 14 of 18 states contacted stated failure of pre-employment drug screening is classified as misconduct and benefits are denied.⁸ However, department policy allows unemployment benefits for claimants on drug-related discharge cases unless signs of on-the-job impairment are found, or unless the job is deemed to be safety sensitive. This policy is based on statutory language which requires misconduct to be "connected with the claimant's work" in order to result in a disqualification of benefits. In accordance with this policy, the department does not consider discharges resulting from the failure of a pre-employment drug test to be misconduct, whereby benefits are awarded in full.

Of the 18 states contacted, 17 also consider the failure of a random drug test to be misconduct and deny or reduce benefits because the employee has knowingly and intentionally disregarded a reasonable employer rule. However, the department's policy requiring proof of on-the-job impairment on drug-related discharges also extends to individuals who fail a random drug test⁹ mandated by a known company policy. Under

⁶Of the 152 determinations reviewed, 48 involved misconduct.

⁷Department data indicates an overall average of 5.7 weeks for 2001 and 5.8 weeks for 2002.

⁸See Appendix III for states contacted and results.

⁹All of the states contacted, as well as Missouri, either had a department policy or state law that required certain quality standards of the labs providing the drug results.

the department's policy, an individual who has been discharged for failing a random drug test, but has exhibited no signs of impairment, would be awarded full benefits.

The Eastern District of the Missouri Court of Appeals has agreed with the department's interpretation of the law as it pertains to drug-related discharges. According to department personnel, unless state law is changed, the department will not alter its handling of these situations. Department personnel also told us employers could avoid claims related to pre-employment drug testing if they gave the test to individuals and did not allow them to start working unless they first passed the drug test.

Unemployment benefits paid on drug-related discharges

Based on our analysis of 50 sampled drug-related discharges during 2001, we estimate the department paid \$4.9 million¹⁰ in unemployment benefits to claimants on 1,960 drug-related discharges. Our estimate of \$4.9 million represents 1 percent of \$476 million in unemployment benefits paid by the department during 2001. Of the 1,960 determinations, 1,327, or 68 percent, were found to be misconduct and the claimant had to serve disqualification waiting weeks before receiving benefits. Based on our analysis of sample results, we estimate the benefits associated with these claims totaled \$2.4 million.

Department personnel found no misconduct on 633, or 32 percent, of the 1,960 determinations and, therefore, the claimant did not have to wait before obtaining unemployment benefits. Based on our analysis of sample results, we estimate the department paid \$2.5 million to these claimants. Department personnel found no misconduct on the 633 claims for the following reasons.

- Employers either refused or failed to provide sufficient information to support a misconduct finding on 270 discharges. Based on our analysis of department data, we estimate \$1.1 million in benefits were paid on these claims.
- Individuals had been put to work and then discharged for failing pre-employment drug tests on 228 discharges. Based on our analysis of department data, we estimate \$909,000 in benefits were paid on these claims.
- No evidence of impairment on the job had been proven, or the employer had not proven drug use had been "connected with work" on 135 discharges. Based on our analysis of department data, we estimate \$538,000 in benefits were paid on these claims.

Conclusions

The department's handling of unemployment claims related to discharge for misconduct generally complies with state laws and department guidance. However, the state's approach to penalizing misconduct discharge claims differs from most states contacted because Missouri law allows an individual discharged for misconduct to collect full

¹⁰See Appendix I for additional information on estimate.

benefits after a waiting period. Although the department can impose a waiting period of up to 16 weeks before benefits are paid, it seldom imposes a waiting period of more than 4 to 8 weeks and does not have a formal policy addressing waiting periods. Missouri also differs because state law does not reduce benefits eventually paid to individuals discharged for misconduct, and state case law requires evidence of on the job impairment to find misconduct on drug-related discharges.

Recommendations

We recommend the General Assembly:

- 1.1 Add a monetary penalty equal to the number of disqualification weeks as a penalty for misconduct discharges.
- 1.2 Review current department policy and established case law regarding the handling of drug-related discharges to determine whether department policy reflects legislative intent.

Based on the disqualification penalties required by the current law, we also recommend the Director of the Department of Labor and Industrial Relations:

- 1.3 Emphasize disqualification penalties.

Agency Comments

DOLIR agreed with recommendation 1.3 and provided the following comments:

The DOLIR will act upon the recommendation to emphasize disqualification penalties. DOLIR will review penalties on nonmonetary determinations to assess the consistency of disqualification penalties. DOLIR training staff has already begun emphasizing disqualification penalty consistency during nonmonetary training sessions currently in progress. DOLIR will also conduct ongoing reviews of nonmonetary determinations to ensure appropriate disqualification penalties are being assessed consistently.

See Appendix V for a copy of DOLIR's letter dated August 13, 2003.

2. Action is Needed To Restore the Solvency of the Fund

Although the 2003 vetoed legislation attempted to address fund solvency by increasing revenue and reducing benefits, the proposed changes would also have (1) caused Missouri employers to incur unnecessary interest charges, (2) delayed restoring the fund's solvency and failed to avoid the imposition of approximately \$275 million in increased federal taxes levied on all Missouri employers, and (3) failed to ensure the fund's long-term solvency. Fund insolvency is forcing the department to borrow federal funds, and Missouri employers may incur as much as \$95 million in interest costs and \$538 million in increased federal taxes if no legislative action is taken to resolve fund insolvency. In addition, timely identification and collection of benefit overpayments would also contribute to the fund's solvency.

Solvency issue has not been resolved

In January 2002, we reported¹¹ the fund would become insolvent in 2003 and it occurred in March 2003. We also recommended the General Assembly take corrective action to ensure the long-term solvency of the fund. The General Assembly passed legislation addressing the fund's solvency during its 2003 session, which the governor vetoed in July 2003. As of the date of this report, no action has been taken to ensure the long-term solvency of the fund.

Vetoed legislation increased revenue and reduced benefits, but costly to employers

Our analysis of department data showed the vetoed legislation would have added \$83 million per year to the fund balance. Proposed changes would have increased revenues by an estimated average of \$33 million per year from 2004 to 2010 by increasing the taxable wage base from \$7,500 to \$8,000 in 2003, and allowing annual \$1,000 adjustments when the fund balance fell below specified levels.¹² Proposed changes also would have reduced benefits by an estimated \$50 million per year. The benefit reduction would have been achieved by not allowing claimants discharged for misconduct to serve disqualification weeks and collect benefits (\$30 million)¹³ and by eliminating waiting-week benefits received after a claimant has collected benefits for nine consecutive weeks (\$20 million). According to department personnel, these changes alone would not ensure the long-term solvency of the fund.

The vetoed legislation would have allowed the fund to accumulate approximately \$200 million by the end of 2010, according to department projections. However, \$200 million is substantially below the USDOL recommended fund solvency level of approximately

¹¹Solvency of the Missouri Unemployment Compensation Trust Fund, Report No. 2002-01, dated January 9, 2002.

¹²The vetoed legislation increased wage base adjustment thresholds and increased the adjustment increment from \$500 to \$1,000.

¹³The legislation proposed claimants discharged for misconduct would not be eligible for benefits until they returned to work, earned at least \$2,000 and became unemployed again.

\$1 billion. Any increase in the unemployment rate over what has been forecasted could result in prolonged insolvency, according to department personnel.

The vetoed legislation also proposed allowing the department to issue up to \$100 million in bonds to finance current and future insolvencies. The vetoed legislation required the bonds be repaid through a special assessment on all employers in the state over a period not to exceed 10 years. Department personnel estimated bond interest payments and issuance costs of approximately \$31 million. Had the vetoed legislation been enacted, department personnel planned to issue \$100 million in bonds during 2004, with additional smaller bond issues in both 2005 and 2006.¹⁴ Department personnel also estimated an additional \$177 million would have to be borrowed from the USDOL for fiscal years 2004 through 2006. Department personnel also estimated approximately \$38 million in interest would accrue on this USDOL debt. The interest accrued on USDOL loans, like the bond repayments, would be paid through a special assessment on all employers in the state.

Our analysis shows the use of bonds to finance the current insolvency would cost employers approximately \$34 million more than financing the full insolvency through USDOL. As discussed above, using bonds to finance the expected insolvency would cost employers interest and bond issue costs of approximately \$31 million (over a 12-year period), and an additional \$38 million in federal interest (over a 6-year period) for a total of \$69 million in finance costs. In addition, department personnel estimate employers would incur an additional \$5 million¹⁵ (over a 2-year period) in increased federal taxes. In contrast, if the bonding provisions of the proposed legislation were not used, and the insolvency was financed solely through USDOL, the only finance charges incurred would be USDOL interest charges of approximately \$40 million (over a 5-year period).

Bonds more
costly to
employers

Proposed use of bonds delays fund solvency and does not avoid federal taxes

The use of bonds and other vetoed changes proposed by the legislature, as well as the imposition of approximately \$275 million in increased federal taxes by USDOL¹⁶ over a 2-year timeframe, allows the fund to resume solvency in 2008.¹⁷ However, if the insolvency were funded solely through USDOL, department personnel estimate the fund would regain solvency a year earlier, in 2007. Without the increased federal tax imposed by USDOL, the fund balance would remain negative through 2010 in both scenarios. Figure 2.1 depicts fund projections through 2010, based on vetoed legislative changes

¹⁴This assumes a portion of the \$100 million would have been repaid during 2005 and 2006 and additional borrowing, not to exceed a total of \$100 million, would have been necessary. Any subsequent bond issue would also incur additional bond issuance costs.

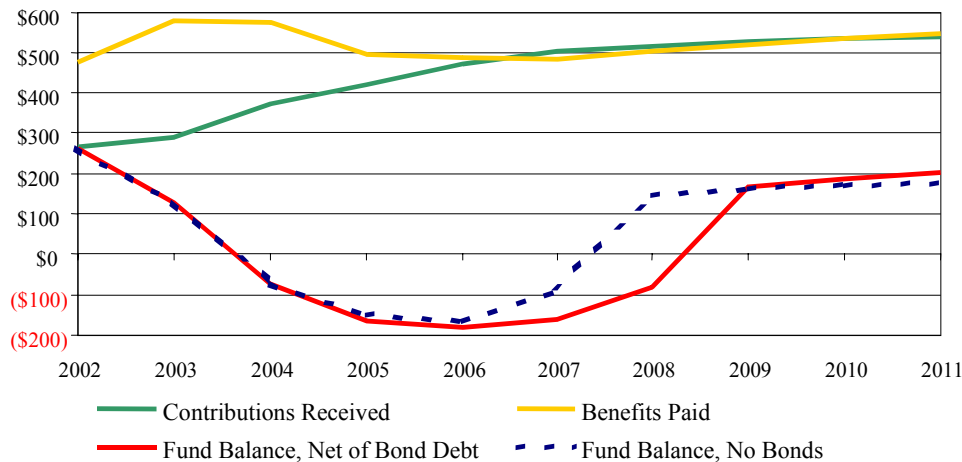
¹⁵USDOL would assess Missouri employers \$275 million in increased federal taxes if the bonding provisions of the vetoed legislation were used, but would assess \$269 million if the amount were fully financed through USDOL. The difference is due to the additional tax starting a year later if bonding were used.

¹⁶The increased federal taxes are used to replenish the fund.

¹⁷Includes bond indebtedness.

and the increased federal tax imposed on employers to repay estimated USDOL loans. It also shows how the fund is expected to react if the insolvency were financed by borrowing from only USDOL (no bonds).

**Figure 2.1: USDOL Impact on Fund Balance Based on Vetoed Legislation
(Dollars in millions)**



Source: Department projections, as of June 2003.

As shown in figure 2.1, the vetoed legislation would have decreased benefits paid in 2004 and increased contributions. By 2006 contributions would have matched payments of benefits and continued that trend through 2010. However, without the additional federal tax imposed by USDOL, the fund balance would remain negative through 2010.

Insolvency forces employers to bear cost of borrowed funds and federal taxes

Department personnel estimate all Missouri employers may incur as much as \$95 million in interest charges on borrowed federal funds through 2009 if action is not taken to resolve fund insolvency. The fund became insolvent in March 2003 forcing the department to borrow \$42 million from the USDOL in order to continue to pay unemployment benefits. In June 2003 the department repaid the \$42 million and, in accordance with state law, all Missouri employers will be required to repay \$410,000 in interest incurred on the debt. The fund regained solvency in April 2003 because of the influx of employer first quarter contributions. However, department personnel estimate the fund will become insolvent again in September 2003¹⁸ and remain insolvent into 2009. This insolvency will necessitate additional federal borrowing, unless changes are made to state law to substantially increase fund revenue.

Employers may incur \$95 million

The fund became insolvent because benefits paid on unemployment claims outpaced employer contributions to the fund by approximately \$500 million in calendar years 2001

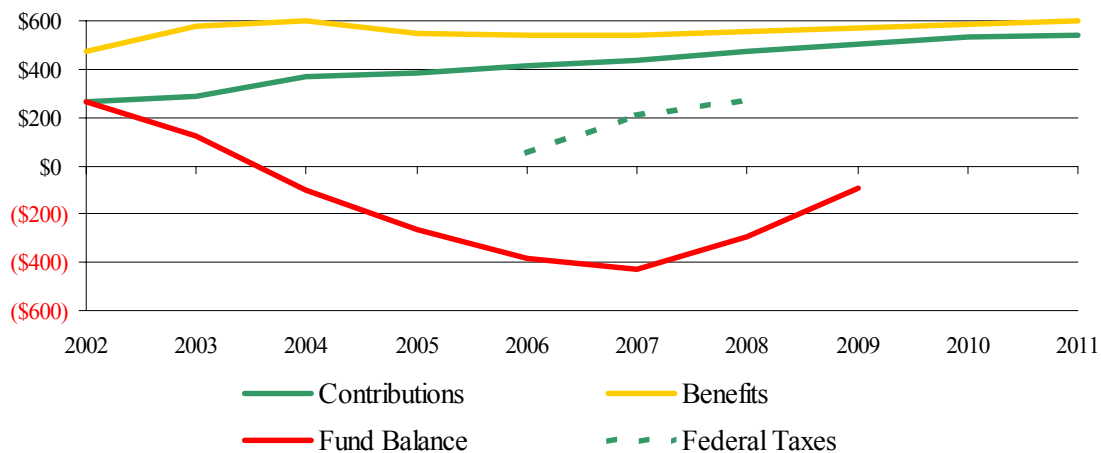
¹⁸The fund became temporary insolvent again in July 2003, causing the department to borrow additional funds.

and 2002. According to department projections, benefits paid will outpace contributions received by an estimated \$879 million between 2003 and 2010 and department personnel estimate the department will have to borrow approximately \$764 million to make benefit payments for the remainder of 2003 through 2008,¹⁹ if no legislative action is taken to address the solvency issue.

Department personnel also estimate all Missouri employers will incur an estimated \$539 million in increased federal taxes through 2007 to repay borrowed federal funds if state officials do not make the fund solvent within two years.²⁰ Department personnel estimate the increased federal tax would begin in 2005, when an estimated \$55 million would be collected. An estimated \$483 million would also be collected between 2006 and 2007. The increased federal taxes are likely to be assessed to Missouri employers in 2008 in order to restore fund solvency, according to department personnel, however, the amount is uncertain. Figure 2.2 depicts the fund balance through 2008 and the impact on the fund deficit once USDOL collects increased federal taxes imposed on employers. Department personnel could not project the fund balance past 2008 since the federal tax assessment amount for out-years is unknown.

Employers will incur \$539 million in taxes

**Figure 2.2: USDOL Impact on Fund Balance Based on Current Law
(Dollars in millions)**



Source: Department projections, June 2003.

As shown in figure 2.2, the projected deficit will increase to approximately \$430 million by the end of 2006. In 2007, the deficit begins to be reduced when USDOL collects the additional federal tax on employers and replenishes the fund. In addition, benefits are projected to exceed contributions every year through 2010.

¹⁹With the assessment of increased federal taxes, no additional borrowing of federal funds will be necessary beyond 2008.

²⁰See Appendix IV for comparison of costs.

Timely identification and collection of overpayments would improve fund solvency

Department personnel estimate as much as \$93 million in benefits has been overpaid to claimants over the past five years (1997-2001). However, department personnel have audited and confirmed only \$53 million (57 percent) of this total because of staffing and time limitations. According to a U.S. General Accounting Office report,²¹ 31 percent of overpayments result from claimants not properly reporting income and 24 percent are the result of fraud by the claimant. As a result, overpayments and the need for their collection can not be eliminated, according to department personnel.

One of the tools currently used by department personnel to identify overpayments is a monthly new-hire cross match. This cross match compares the department's database of claimants receiving benefits with federal Form W-4²² data of recently employed individuals from the Missouri Department of Revenue. This cross match identifies individuals potentially receiving improper benefits by not reporting wages being earned in their new jobs. The department currently requests the new-hire data on a monthly basis. Our analysis of a limited number²³ of these new hires disclosed a 36-day average time lapse between the federal Form W-4 completion date and the date department personnel obtained the data. However, an official from the Division of Child Support Enforcement, who stores the data for the Department of Revenue, told us the data is available on a weekly basis. Department personnel acknowledged obtaining this data on a weekly basis would be the most feasible means to reduce the amount of overpayments made, but they could not quantify the potential fiscal impact on the fund.

The vetoed legislation proposed the department perform a monthly cross-match against any federal new-hire data available. However, due to the cross-match already performed against state new-hire data, a department official stated the proposed federal cross-match would have no impact on the department's ability to identify overpayments or on fund solvency. According to the official, the department can not audit all state cross-match hits it already identifies due to limited federal administration funding. Any additional staffing would need to be funded with state funds, according to the official.

Over the past 5 years the department has collected \$27 million, or 51 percent, of the \$53 million in overpayments. However, approximately \$26 million has gone uncollected. According to department personnel, collection efforts are hampered because staffing is limited by federal funding. All collections go directly into the trust fund.

**\$26 million in
overpayments
uncollected**

²¹Unemployment Insurance: Increased Focus on Program Integrity Could Reduce Billions in Overpayments, GAO-02-697, July 2002.

²²All employees normally fill out a federal Form W-4 (Employee's Withholding Allowance Certificate) so their employer can withhold the correct federal income tax from their pay. The employer forwards the Form W-4 to the Department of Revenue.

²³The 138 cases reviewed included 21 cases involving an overpayment. Since Federal Form W-4 data is not maintained by the department, we were limited to determining the time lapse between Form W-4 completion and the date the department obtained the data to five of the overpayment cases.

Department personnel have considered alternatives to increase collections without increasing staff. For example, they have considered using a collection agency to collect uncollectible overpayments. Federal regulations allow the use of a collection agency for this purpose. However, additional administrative funding would be needed to pay costs associated with this service and claimant confidentiality issues would have to be overcome, according to department personnel

Conclusions

Missouri has been forced to borrow funds from USDOL to return the fund to temporary solvency. If no corrective action is taken to resolve insolvency, the fund is expected to remain insolvent until 2009, with benefits exceeding contributions through 2010. The department has borrowed \$42 million and expects to borrow \$764 million through 2008 unless revenue is increased and/or benefits are reduced. Missouri employers are estimated to incur \$95 million in interest charges on borrowed federal funds during that timeframe. If the state does not take action to sufficiently correct the insolvency within 2 years, USDOL may impose as much as \$539 million in increased federal unemployment taxes on all Missouri employers through 2007 to eliminate the existing fund deficit.

The vetoed legislation proposed increasing revenues and decreasing benefits. It also authorized the issuance of \$100 million in long-term bonds which would have resulted in all Missouri employers paying an estimated additional \$34 million in interest charges when compared to the cost of borrowed federal funds. The proposed use of long-term bonds to finance the insolvency would have placed an unnecessary additional financial burden on all employers since fund deficits can be financed through USDOL.

The vetoed legislation also did not allow the fund to accumulate a sufficient balance to ensure its long-term solvency. Without a sufficient balance, the fund will resume a deficit position with any future recession. Corrective action could eliminate the need for imposition of substantial increased federal taxes which will also have to be repaid by all employers.

Although not a major factor affecting the fund's solvency, timely identification of overpayments of unemployment benefits and enhanced collection of overpayments would improve fund solvency. Obtaining new-hire data on a weekly basis could reduce overpayments. Department officials should also carefully assess the feasibility of using a collection agency to reduce the amount of uncollectible overpayments.

Recommendations

We recommend the General Assembly:

2.1 Take action to resolve the solvency of the fund.

We also recommend the Director of the Department of Labor and Industrial Relations:

- 2.2 Obtain Department of Revenue cross-match data on a weekly basis.
- 2.3 Determine the feasibility of using a collection agency to enhance collections of overpayments of unemployment benefits.

Agency Comments

In response to recommendations 2.2 and 2.3, DOLIR officials provided the following, respectively.

The DOLIR will act upon the recommendation to obtain new-hire cross-match data on a weekly basis, rather than a monthly basis, from the Department of Revenue as soon as possible. Obtaining this data on a weekly basis would be the most feasible means to reduce the amount of overpayments made and the DOLIR intends to promptly submit to its Information Systems Section an Information Systems Service Request for programming to implement this change. As of July 31, 2003, contacts had already been made with the Division of Child Support Enforcement and the Department of Revenue to receive the cross-match data weekly.

Efforts to collect unemployment benefit overpayments are hampered because DOLIR staffing is limited by federal funding. The DOLIR agrees with the recommendation to determine the feasibility of using a collection agency in order to enhance collections of overpayments of unemployment benefits. The DOLIR has considered using a collection agency to collect uncollectible overpayments and federal rules do not prohibit the use of such an agency for this purpose. In assessing the feasibility of this recommendation to reduce the amount of uncollectible overpayments, it is noted that there are no statutory provisions allowing the DOLIR to use recovered Unemployment Compensation Trust Fund monies to pay a collection agency to collect overpayments of unemployment benefits. Additional financial support, therefore, would be needed to pay costs associated with this service. The DOLIR would have to either request General Revenue funds or redirect limited federal administrative funding, which would cause a reduction in monies that are used for other unemployment insurance functions. Lastly, the DOLIR would have to overcome claimant confidentiality issues if a collection agency is used for collecting unemployment benefit overpayments.

See Appendix V for a copy of DOLIR's letter dated August 13, 2003.

SAMPLE METHODOLOGY AND RESULTS

This appendix describes how we identified study populations and our sampling methodology for two statistical samples.

Results of drug case review

To ascertain whether department personnel had properly determined individuals discharged for alleged drug abuse were entitled to receive unemployment benefits, we reviewed a statistical sample of 50 cases from a study population of 1,960 cases involving drug abuse. Department personnel identified cases involving alleged drug abuse during calendar year 2001. We based sample size on a 90 percent confidence level with a 7 percent precision and an expected error rate of 10 percent.

Based on the results of the sample, we estimate department personnel followed guidance set out by state statutes for 92 percent of the study population, or 1,803 of the 1,960 determinations. Table I.1 displays sample results.

Table I.1: Results of Review of Drug-Related Cases

Category	Result
Sample size	50
Correct determinations	46
Point estimate success rate	92%
Point estimate quantity	1,803
Upper limit success rate	97.2%
Upper limit quantity	1,905
Lower limit success rate	82.7%
Lower limit quantity	1,621

Based on the results of the sample, we estimate department personnel did not follow guidance set out by state statutes for 8 percent of the study population, or 157 determinations. Table I.2 displays sample results.

Table I.2: Results of Review of Drug-Related Cases

Category	Result
Sample size	50
Errors	4
Point estimate error rate	8%
Point estimate quantity	157
Upper limit error rate	17.3%
Upper limit quantity	339
Lower limit error rate	2.8%
Lower limit quantity	55

Total paid to claimants in drug related cases

To determine the amount of unemployment benefits paid to claimants with drug-related discharge issues, we reviewed a statistical sample of 50 drug-related cases from a study population of 1,960 cases involving drug abuse. Department personnel identified cases involving alleged drug abuse during calendar year 2001.

Based on the results of the sample, we estimate the amount paid to claimants involved in 1,960 drug-related cases totaled \$4.9 million, at a 90 percent confidence level. Table I.3 displays sample results.

Table I.3: Amounts Paid to Claimants with Drug-Related Cases

Category	Results ¹
Sample size	50
Point estimate	\$ 4.9
Lower limit	\$ 3.9
Upper limit	\$ 5.9
Precision amount	\$ 1.0
Precision	+19.7%

¹ Dollars in millions

Total paid to claimants on drug-related cases determined to be non-misconduct

To ascertain the amount of unemployment benefits paid to claimants on drug-related cases determined to be non-misconduct cases, we reviewed a statistical sample of 50 drug related cases from a study population of 1,960 cases involving alleged drug abuse. Department personnel identified drug-related cases determined to be non-misconduct during calendar year 2001.

Based on the results of the sample, we estimate the total amount paid to claimants involved in drug-related cases determined to be non-misconduct is \$2.5 million, at a 90 percent confidence level. Table I.4 displays sample results.

Table I.4: Amounts Paid to Claimants – Non-misconduct Cases

Category	Results ¹
Sample size	50
Point estimate	\$ 2.5
Lower limit	\$ 1.7
Upper limit	\$ 3.4
Precision amount	\$.9
Precision	+33.9%

¹ Dollars in millions

Total paid to misconduct claimants serving disqualification weeks

To determine the amount of unemployment benefits paid to claimants serving disqualification weeks for misconduct on cases involving alleged drug-related cases, we reviewed a statistical sample of 50 cases from a study population of 1,960 cases involving alleged drug abuse.

Department personnel identified drug related cases determined to be misconduct during calendar year 2001.

Based on the results of the sample, we estimate unemployment benefits paid to claimants involved in drug-related cases, where misconduct had been determined, totaled \$2.4 million, at a 90 percent confidence level. Table I.5 displays sample results.

Table I.5: Total Paid to Misconduct Claimants Serving Weeks

Category	Results ¹
Sample size	50
Point estimate	\$ 2.4
Lower limit	\$ 1.5
Upper limit	\$ 3.3
Precision amount	\$.9
Precision	<u>+38.2%</u>

¹Dollars in millions

OTHER STATES' PENALTIES FOR MISCONDUCT DISCHARGES

Table II.1 displays state penalties for misconduct discharges, those states that reduce benefits along with the disqualification waiting period, and those states denying unemployment benefits for misconduct claims.

Table II.1: Misconduct Penalties by State

State	Waiting Period/ Denial of Benefits	Benefits Reduced Following Disqualification
Alabama	3-7 weeks	Y
Alaska	5 weeks	Y
Colorado	10 weeks	Y
Nebraska	7-10 weeks	Y
South Carolina	5-26 weeks	Y
Washington, D. C.	7 weeks	Y
West Virginia	6 weeks	Y
Arkansas	7 weeks	N
Maryland	5-10 weeks	N
Missouri	4-16 weeks	N
New Jersey	5 weeks	N
Vermont	6-12 weeks	N
Arizona	Denial	
California	Denial	
Connecticut	Denial	
Delaware	Denial	
Florida	Denial	
Georgia	Denial	
Hawaii	Denial	
Idaho	Denial	
Illinois	Denial	
Indiana	Denial	
Iowa	Denial	
Kansas	Denial	
Kentucky	Denial	
Louisiana	Denial	
Maine	Denial	
Massachusetts	Denial	
Michigan	Denial	
Minnesota	Denial	
Mississippi	Denial	
Montana	Denial	
Nevada	Denial	
New Hampshire	Denial	
New Mexico	Denial	

OTHER STATES' PENALTIES FOR MISCONDUCT DISCHARGES

State	Waiting Period/ Denied	Benefits Reduced Following Disqualification
New York	Denial	
North Carolina	Denial	
North Dakota	Denial	
Ohio	Denial	
Oklahoma	Denial	
Oregon	Denial	
Pennsylvania	Denial	
Rhode Island	Denial	
South Dakota	Denial	
Tennessee	Denial	
Texas	Denial	
Utah	Denial	
Virginia	Denial	
Washington	Denial	
Wisconsin	Denial	
Wyoming	Denial	

Source: U.S. Department of Labor data.

Those states marked "denial", deny misconduct claims unless the individual has earned a certain level of wages since the separation. The level of wages required varies by state.

Alabama, Maryland and West Virginia only use disqualification weeks for less serious misconduct claims and deny claims involving more serious instances of misconduct.

OTHER STATES' TREATMENT OF DRUG RELATED DISCHARGES

Table III.1 depicts whether job impairment must be proven to constitute misconduct and whether a positive pre-employment drug constitutes misconduct for Missouri and 18 other states. As shown, 17 of 18 states contacted consider failure of a random drug test misconduct and 14 states consider failure of pre-employment drug testing misconduct.

Table III.1: Other States' Handling of Drug Related Discharges

State¹	Failure of Random Drug Test Considered Misconduct	Failure of Pre- employment Drug Test Considered Misconduct
Alabama	X	X
Alaska	X	X
Arkansas	X	
Colorado	X	X
Florida	X	X
Illinois	X	X
Iowa	X	X
Kansas	X	
Kentucky	X	X
Maryland	X	X
Nebraska	X	X
New Jersey	X	X
Oklahoma	X	X
South Carolina	X	X
Tennessee	X	X
Vermont	X	
Washington, D. C.	X	X
West Virginia		

¹For purposes of this survey, auditors counted Washington, D. C. as a state.
Source: SAO phone survey of the states noted.

SUMMARY OF FINANCE COSTS AND INCREASED FEDERAL TAXES

Table IV.1 summarizes and compares the amount of finance costs and increased federal unemployment taxes that would be incurred under the (1) vetoed legislation assuming bonding provisions were not used, (2) vetoed legislation using bonds, and (3) current law.

Table IV.1: Comparison of Finance Costs and Federal Taxes (In millions)

Description	Vetoed Legislation Without Bonds	Vetoed Legislation With Bonds	Current Law
Interest to be paid to USDOL	\$40	\$38	\$95
Bond interest	0	26	0
Bond issue costs	0	5	0
Total Insolvency Finance Costs	\$40	\$69	\$95
Increased federal unemployment taxes ¹	\$269	\$274	\$539
Year fund regains solvency	2007	2008	2009

Source: Department projections, as of June 2003

¹The increased federal unemployment taxes will be placed in the fund to repay any outstanding USDOL loans.

DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS' COMMENTS

BOB HOLDEN
GOVERNOR

MISSOURI DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS

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CATHERINE B. LEAPHEART
DEPARTMENT DIRECTOR

AMENDED

August 13, 2003

The Honorable Claire McCaskill
Auditor of the State of Missouri
State Capitol Building, Room 224
Jefferson City, MO 65101

Dear Auditor McCaskill:

I am writing in response to the draft Performance Audit on the "Review of the Missouri Unemployment Compensation Trust Fund" for 2003, which the State Auditor's Office recently presented during a preliminary exit conference for the audit that was conducted on the Department of Labor and Industrial Relations (DOLIR) – Division of Employment Security (DES). The audit was conducted between January and May 2003.

As requested, the DOLIR is providing the following response to the preliminary audit recommendations.

In the draft audit report, it was recommended that, "the General Assembly take action to resolve the solvency of the fund; the DOLIR obtain new hire cross-match data on a weekly basis from the Department of Revenue; and, the DOLIR determine the feasibility of using a collection agency to enhance collections of overpayments of unemployment benefits."

Auditee's Response

We agree with the auditors' findings and recommendations.

The DOLIR agrees heartily with the recommendation to the General Assembly to take action to return the Unemployment Compensation Trust Fund to solvency and to ensure its long-term solvency. Fund insolvency is forcing the DOLIR to borrow federal funds and all employers liable to Missouri may have to incur as much as \$95 million in interest. If the state does not take action to sufficiently correct the insolvency within two years, the United States Department of Labor (USDOL) may impose as much as \$539 million in increased federal unemployment taxes on those employers through 2007 to eliminate the existing fund deficit. In correcting the insolvency, the General Assembly needs to pass legislation that allows the fund to accumulate a sufficient balance to ensure its long-term solvency. Without a sufficient balance, the fund will resume a deficit position with any future recession. The DOLIR concurs that corrective action could eliminate the need for imposition of substantial increased federal taxes, which will also have to be repaid by all employers liable to Missouri.

DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS' COMMENTS

The Honorable Claire McCaskill
August 13, 2003
Page 2

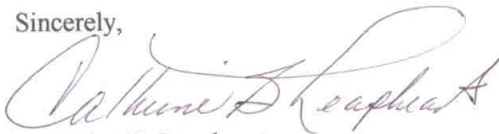
The DOLIR will act upon the recommendation to emphasize disqualification penalties. DOLIR will review penalties on nonmonetary determinations to assess the consistency of disqualification penalties. DOLIR training staff has already begun emphasizing disqualification penalty consistency during nonmonetary training sessions currently in progress. DOLIR will also conduct ongoing reviews of nonmonetary determinations to ensure appropriate disqualification penalties are being assessed consistently.

The DOLIR will act upon the recommendation to obtain new-hire cross-match data on a weekly basis, rather than on a monthly basis, from the Department of Revenue as soon as possible. Obtaining this data on a weekly basis would be the most feasible means to reduce the amount of overpayments made and the DOLIR intends to promptly submit to its Information Systems Section an Information Systems Service Request for programming to implement this change. As of July 31, 2003, contacts had already been made with the Division of Child Support Enforcement and the Department of Revenue to receive the cross-match data weekly.

Efforts to collect unemployment benefit overpayments are hampered because DOLIR staffing is limited by federal funding. The DOLIR agrees with the recommendation to determine the feasibility of using a collection agency in order to enhance collections of overpayments of unemployment benefits. The DOLIR has considered using a collection agency to collect *uncollectible* overpayments and federal rules do not prohibit the use of such an agency for this purpose. In assessing the feasibility of this recommendation to reduce the amount of *uncollectible* overpayments, it is noted that there are no statutory provisions allowing the DOLIR to use recovered Unemployment Compensation Trust Fund monies to pay a collection agency to collect overpayments of unemployment benefits. Additional financial support, therefore, would be needed to pay costs associated with this service. The DOLIR would have to either request General Revenue funds or redirect limited federal administrative funding, which would cause a reduction in monies that are used for other unemployment insurance functions. Lastly, the DOLIR would have to overcome claimant confidentiality issues if a collection agency is used for collecting unemployment benefit overpayments.

Thank you for providing us with an opportunity to respond to the draft report of the Performance Audit on the "Review of the Missouri Unemployment Compensation Trust Fund". If we may provide you with any further information, please do not hesitate to contact me at (573) 751-9691.

Sincerely,



Catherine B. Leapheart
Director

c: Kirk Boyer, Director of Performance Audits
Cynthia Quetsch, DOLIR Deputy Director
Gracia Yancey Backer, DES Director